LIBRARY
SUPREME COURT, U.S.

Office - Supreme Court, U. S.
FILED
SEP 8 1950
CHARLES ELMORE CROPLEY

No. 212

In the Supreme Court of the United States

OCTOBER TERM, 1950

SECURITIES AND EXCHANGE COMMISSION, PETITIONER

v.

M. VICTOR LEVENTRITT

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

SUPPLEMENTAL MEMORANDUM FOR THE SECURITIES AND EXCHANGE COMMISSION

In the Supreme Court of the United States

OCTOBER TERM, 1950

No. 212

SECURITIES AND EXCHANGE COMMISSION, PETITIONER

v.

M. VICTOR LEVENTRITT

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

SUPPLEMENTAL MEMORANDUM FOR THE SECURITIES AND EXCHANGE COMMISSION

This memorandum is submitted in order to bring to the attention of the Court the decision of the Court of Appeals for the Third Circuit in *In the Matter of The Commonwealth & Southern Corp.*, on August 23, 1950, reprinted as an appendix hereto, *infra*, pp. 5-14. That decision creates a clear conflict with that of the Second Circuit in the instant case.

Like this case, the *Commonwealth & Southern* case involved a reorganization of a holding company pursuant to Section 11(e) of the Act, in which one of the issues was the treatment to be accorded to perpetual warrants giving the holder thereof an option to purchase common stock of the company at $30 a share. The Commission approved a plan of

reorganization which, *inter alia,* excluded the warrant holders from participation. The District Court enforced the plan, stating with respect to the warrants that the Commission's "findings are sustained by adequate evidence." On appeal, a warrant holder, represented by counsel who is the respondent herein, challenged the Commission's findings, and the Court of Appeals for the Third Circuit affirmed.

In its decision, the Third Circuit expressly approved the valuation procedure which the Commission followed both in that case and the instant case. The court upheld the Commission's determination that compensation is to be accorded to warrant holders for terminating their option if, and only if, on the basis of reasonably foreseeable earnings, the common stock subject to the warrant might reach a value approximating the exercise price; but where all of the foreseeable factors make it improbable that the value of the common stock would approximate the exercise price, the value of the warrants, if any, is not susceptible of measurement on any rational basis and cannot be given any recognition in the Section 11(e) reorganization (pp. 7-11, *infra*). In the latter circumstance, as the Third Circuit noted, recognition of the warrants would require the Commission "to assume the role of soothsayer and venture a prediction as to a valuation for the options based upon some visionary conception of what the future could bring," and any finding of positive value would be "sheer conjecture

based on an arbitrary assumption which would be quite contrary to the rationale of the Otis and Engineers cases" (pp. 11, 12, *infra*). It is this over-all approach, which in his brief in opposition to certiorari (p. 3) respondent herein labels as "fantastic" and which, he states, the Second Circuit properly rejected.

In the *Commonwealth & Southern* case appellant, in arguing that the Commission erred in not finding a positive value for the warrants, relied on a chart relating to the annual mean prices of the common stock and of the warrants for the years 1931-1948. As to such evidence, which was also before the Commission in the *Niagara Hudson* case (R. 90, 137), and which the Second Circuit deemed so important (R. 123-124, 126), the Third Circuit stated that at best it would be "only some evidence of going business value . . . only remotely connected, if at all, with a determination of the going business value of an option warrant, which is the test laid down by the Otis and Engineers opinions" (p. 12, *infra*). As in the *Niagara Hudson* case, the Commission had before it evidence that "the possibility of future earnings of Commonwealth sufficient to establish value in the warrants was extremely remote" (p. 13, *infra*), and such evidence "is not eliminated or necessarily rendered less credible" because of past market prices for the warrants, which "represent, to a large extent, out and out market gambling," and "speculation as to what the Commission's course would be

in connection with the option warrants in question" (p. 13, *infra*).

The Third Circuit refers to the decision of the Second Circuit, noting "the similarities in the two cases" and the latter court's agreement that the Commission's findings must be affirmed if supported by substantial evidence and arrived at in accordance with the legal standards (pp. 13-14, *infra*), but an analysis of its opinion makes it clear that what the Third Circuit regarded as "abundant evidence" (p. 14, *infra*), the Second Circuit regarded as neither substantial nor insubstantial (R. 126); and that past market history, which the Second Circuit regarded as "positive evidence" of value (R. 124), the Third Circuit considered of little, if any, significance.[1]

It is clear, therefore, that there now exists a conflict of decisions in the circuits on the issue presented by the petition herein, which provides an additional reason for granting the writ.

Respectfully submitted,

PHILIP B. PERLMAN,
Solicitor General.

ROGER S. FOSTER,
General Counsel,
Securities and Exchange Commission.

SEPTEMBER 1950.

---

[1] It may be noted that the past market prices of the common stock and of the warrants were an integral part of the Commission's findings in the *Niagara Hudson* case (R. 90).

APPENDIX

UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT

No. 10,045

In the Matter of

THE COMMONWEALTH & SOUTHERN CORPORATION, ADELAIDE H. KNIGHT, APPELLANT

Appeal from an Order of the District Court of the United States for the District of Delaware

Argued January 17, 1950

Before Goodrich, McLaughlin and Hastie, Circuit Judges

OPINION OF THE COURT—Filed August 23, 1950

By McLAUGHLIN, *Circuit Judge.*

This is an appeal from the order of the District Court of July 15, 1949, approving and enforcing a plan, as amended, filed with the Securities and Exchange Commission by the Commonwealth & Southern Corporation, pursuant to Section 11(e) of the Public Utility Holding Company Act of 1935, 49 Stat. 820.

Appellant is the owner of Commonwealth option warrants. She first appeared in this matter at the hearing in the District Court. She did not participate in the proceeding before the Commission and offered no evidence in the District Court. The options receive nothing under the amended plan. The Court below found that while this was regrettable

"* * * the SEC's action has not been contrary to law and its findings are sustained by adequate evidence." In re Commonwealth & Southern Corporation, D.C. Del., 84 F. Supp. 809, 811.

A phase of this litigation was before us some time ago when appellant, after taking her appeal, applied for a stay of the enforcement of the plan, pending argument on the merits. The stay was denied and on October 1, 1949, the plan was effected, the corporation was dissolved and its assets distributed. Appellant and the intervenor are the only objectors to the plan.

Appellant urges that the options had substantial value for which compensation should have been provided in the plan.

Under a Commonwealth option warrant, its holder, after September 1, 1949, had the right to purchase a share of common stock "as its Common stock may be constituted at the time of purchase at a price of $30. per share." The Commission found that "the option warrants have no recognizable value and that the holders of such warrants are not entitled, under the standards of fairness and equity, to any participation in the reorganization of Commonwealth."

"The Commission's findings as to valuation, which are based upon judgment and prediction, as well as upon 'facts,' * * * are not subject to reexamination by the court unless they are not supported by substantial evidence or were not arrived at 'in accordance with legal standards.'" S.E.C. vs. Central-Illinois Securities Corp., 338 U.S. 96, 126. This is the test to be applied to the case before us.[1]

---

[1] See Professor Dodd's article, 63 Harv. Law Rev. 298.

The Commission's holding that the option warrants had "no recognizable value" is solidly supported by the record. The President of Commonwealth testified that the Commonwealth board of directors, even under the most optimistic view of possible paid up earnings by its subsidiaries, saw no prospect of the type of earnings which would make the common stock worth $30 a share and for that reason made no provision for the warrants.[2] Hartt, the Commonwealth expert, gave as his judgment that the warrants were not entitled to any compensation because it was almost inconceivable that Commonwealth would attain such earnings as would result in a price of $30 a share for the common stock, even though the stock were sold in the future at fifteen to twenty times earnings—in his opinion an unreasonable expectation. Appellant does not challenge the evidence before the Commission on which the latter based its conclusion, also not challenged, that "the reasonably foreseeable consolidated net income of Commonwealth may be estimated to average about $30,000,000 a year." Nor does appellant dispute the Commission's calculation that such an income, applied proportionately to the various interests in Commonwealth, if Commonwealth remained in existence, would be equivalent to about 63¢ per share of Commonwealth's common stock. That figure would require capitalization of earnings of about forty-eight times in order to make the exercise of the option advantageous to its owner. From 1931 to the date of the Commission decision the highest market price on the common had been 6⅛, so that the call could have

---

[2] Cf. Ecker vs. Western Pacific R. Corp., 318 U.S. 448 at 476.

no value unless the stock rose to nearly five times that top figure. The market price of the common shares which obtained around the time of the said decision would have to increase from nine to ten times to give value to the call. There is no disagreement with the Commission's judgment that Commonwealth earnings included the savings from refunding operations and that there is no likelihood of any further real savings through refinancing. With this in mind, it is important to note that on the Commission's compilations, the Commonwealth subsidiaries as of the close of the Commission hearing were earning 6.6% upon their rate base. Capitalized at fifteen times earnings, certainly a liberal expectation, the rate of return would have to increase to 12.5% for the holding company stock to reach a value of $30 a share. Such increase would not be allowed in the strictly regulated public utility industry of which Commonwealth's subsidiaries are a part. The above resume of the testimony leaves no doubt but that the Commission's decision is well within the substantial evidence rule.

Assuming that the Commission had before it conflicting evidence as to value, that part of the evidence on which the Commission based its findings is not destroyed. And with the scope of our review limited, as it is, though we might disagree with the result reached, so long as that result is supported by substantial evidence we are without power to alter it. "As said in National Labor Relations Board v. Link-Belt Co., 311 U. S. 584, 597, 61 S. Ct. 358, 365, 85 L. Ed. 368: 'Congress entrusted the Board, not the courts, with the power to draw inferences from the facts. * * * The Board, like other expert agencies dealing with specialized fields * * *

has the function of appraising conflicting and circumstantial evidence, and the weight and credibility of testimony'. The rules quoted are applicable here." Pacific Gas & Electric Co. vs. S.E.C., 9 Cir., 127 F. 2d 378, 384, 139 F. 2d 208, affd. at 324 U.S. 826.

Appellant insists that the SEC refused to recognize what she calls the "trading value" or "premium value" of the warrants. This value is based, says appellant, on the perpetual call feature of the warrants, warrant holders having the right "to share in unanticipated earnings which, when they become foreseeable, push the market price of the stock beyond the level of the option price at which the warrants can be exercised."[3] We agree that

---

[3] By her own reasoning, appellant demonstrates an inherent weakness in her position. In her argument on this branch of the case she says that "common stock in a continuing enterprise represents the residual chance to make a profit * * *. This opportunity encompasses two distinct elements: (1) anticipated earnings and (2) those earnings which cannot be foreseen but which may nevertheless eventuate." Appellant says "* * * that the warrants, * * *, reflect a portion of the second element of value, * * * that a going concern will realize now unforeseen earnings." Assuming arguendo all that appellant sets forth on this point, it seems clear that the warrant holders should not get what the common stockholders are denied, namely, some return on a going concern basis for profits which are not foreseeable. Under the practice followed by the Commission, the common stock receives a valuation based on foreseeable earnings in an 11(e) proceeding.

If there is no probability of earnings sufficient to boost the price of the stock to the level of the option exercise price, the warrant holder should not receive value based on a mere possibility, or less than that, of future earnings at the expense of the group of stockholders entitled to that value. If, at the time of the simplification proceeding, the once unanticipated profits, (sufficient to boost the price of the common stock to the exercise price) can, with some degree of probability, be seen in the reasonably foreseeable future, then, and only then, is the warrant holder entitled to receive a positive valuation for his option.

"* * * the Commission was required to give proper recognition to the value of the perpetual feature of the warrants." In re Electric Power & Light Corp., 2 Cir., 176 F. 2d 687, 691. But the SEC cannot, at the expense of the other security holders, place an affirmative valuation upon option warrants which have no chance, so far as the Commission can see, of being exercised at a figure favorable to the warrant holders within the reasonably foreseeable future.[4]

In connection with this phase of the appeal, future inflation stemming from possible results of the international situation and other possibilities are suggested as additional elements of value for the warrants. It is, therefore, contended that the warrants have a tangible worth and that the Commission failed to consider such elements in arriving at its determination. It is said, in effect, that the Commission erred in law by not speculating about any and all contingencies which, within the realm of possibility, might arise and, so arising, increase the common stock value of Commonwealth—increase it to almost five times the highest market price in the last eighteen years and nine to ten times its market price about the time of the Commission decision.

The Commission opinion makes it clear that all pertinent factors in our economy were considered

---

[4] In addition, it is possible that the following holding of the Supreme Court might well be construed to be applicable here, and in fairness to all the security owners, would preclude the placement of a positive value on the warrants. In the Otis case the Supreme Court held that pre-existing contract provisions which produce results at variance with a legislative policy, which was not foreseeable when the contract was made, cannot be permitted to operate.

in reaching its decisions regarding the investment value of the various Commonwealth interests. Those conclusions are founded on the record and were arrived at, as we see it, " 'in accordance with legal standards' ". S.E.C. vs. Central-Illinois Securities Corporation, (supra, p. 126). The problem was one peculiarly for the Commission under the Engineers decision, S.E.C. vs. Central-Illinois Securities Corporation (supra). It has been resolved by what, we think, was the sound judgment of the Commission in refusing to assume the role of soothsayer and venture a prediction as to a valuation for the options based upon some visionary conception of what the future could bring. The Commission properly discharged its function when it made its best expert determination as to the yearly earnings within the reasonably foreseeable future, and, calculating therefrom and using the other pertinent evidence adduced, finally arrived at its conclusion.

The suggestion is made that by refusing compensation for the options, the Commission has given to one class of security holders what had been sold to another class. Otis & Co. vs. S.E.C., 323 U.S. 624, is cited for this but is validly distinguishable from the issue at bar. There, the Commission had determined that the common stock in question had a legitimate investment value, based on the forecast earnings, of a proportion of about 5½% of the corporate assets to the preferred's value of about 94½%. The valuations given the securities were grounded on foreseeable earnings with a reasonable probability of actual realization. Those valuations were upheld on appeal. In this matter, the Commission, on strong believable evidence, has found

that the options have no practical value. Any other finding on the particular facts would have been sheer conjecture based on an arbitrary assumption which would be quite contrary to the rationale of the Otis and Engineers cases.

The Commission rightly concedes that under certain facts an option warrant can have a recognizable value, as in the Electric Power & Light Corp. case—S.E.C. 1949, H.C.A. Release #8889, approved as In re Electric Power & Light Corp., supra, where "* * * there is the probability of the market price of Electric's common stock exceeding the exercise price of the warrant within the foreseeable future" but that is not the situation before us, where the Commission had no sound foundation from either the figures or testimony on which to make that kind of estimate.

It is said that the Commission should have been governed solely by what is asserted to have been their market value in determining the worth of the warrants. In support of this a chart is offered covering the years from 1931 to 1948. This shows that the annual mean prices of the common stock and of the options have a ratio of approximately eight to one. Appellant contends that the Commission must allow participation by the warrant holders in that proportion. We disagree. Were the proportionate table submitted by appellant a far more accurate gauge of market value than it is, it would still be only some evidence of going business value and in no wise controlling. Such evidence is only remotely connected, if at all, with a determination of the going business value of an option warrant, which is the test laid down by the Otis and Engineers opinions. The Commission had before it evi-

dence, which it was entitled to accept, that the possibility of future earnings of Commonwealth sufficient to establish value in the warrants was extremely remote. That evidence is not eliminated or necessarily rendered less credible, simply because there was testimony from which some value could be attributed to the stock. At any rate, we think the option prices during the years covered represent, to a large extent, out and out market gambling, plus (since the existence of the Commission and its consideration of this case) deliberate speculation as to what the Commission's course would be in connection with the option warrants in question.[5]

The same market value evidence regarding the warrants upon which appellant relies was, of course, before the Commission. The circumstance that it was not referred to in the Commission opinion is no indication that it was ignored. What appellant is really complaining about is the Commission's non-acceptance of it. It follows that there is no reason for remanding this matter to the Commission for the taking of additional evidence on market value of the warrants.

The Second Circuit decision in S.E.C. vs. Leventritt, 179 F. 2d 615, involving the reorganization of the Niagara Hudson Power Corporation, agrees that where the Commission's holding is supported by substantial evidence and was arrived at in accordance with legal standards, it must be affirmed. But in that opinion the Court found that the record

---

[5] In 1942, in simplification proceedings, the Commission had directed that the warrants be eliminated from Commonwealth's corporate structure and this was upheld by us in Commonwealth & Southern Corporation vs. S.E.C., 134 F. 2d 747.

contained nothing to sustain the Commission decision that the Niagara options were valueless. We take the view, already expressed, that the record in the case before us contained abundant evidence to support the Commission's decision. In reaching this conclusion, we are not unaware of the similarities in the two cases.

On the evidence, the Commission properly held that the Commonwealth option warrants had "no recognizable value". Applying the "fair and equitable" test, it found that the warrants were not entitled to any participation in the reorganization of Commonwealth. In so deciding, we think that the Commission was within its statutory authority and that the District Court correctly approved its action.

The judgment of the District Court will be affirmed.

Judge Hastie concurs in the result.

A true Copy:

Teste:

_____,

Clerk of the United States Court of Appeals for the Third Circuit.

☆ U. S. GOVERNMENT PRINTING OFFICE 1950 904017 110